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POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

Section 407 Inquiry	Docket No. PI2012-1

REPLY COMMENT OF JAMES I. CAMPBELL JR.
(August 31, 2012)

In Order No. 1451 (Aug. 28, 2012), the Commission invited the reply comments in this docket. In this document, I shall reply to a few points raised in the initial comments.

At the outset, however, I would like to commend the Commission for initiating this public inquiry and, again, for inviting reply comments. For too long public policy issues presented by intergovernmental agreements fixing, or authorizing public postal operators to fix, charges for delivery of international postal items have been shrouded in secrecy and misinformation. As a result, the international postal world has largely missed the modernizations which have, to a greater or lesser extent, adapted the great domestic postal services to the evolving needs of modern society. Yet, despite arcane terminology and an aura of international intrigue, the policy issues presented by international postal services — certainly the exchange of postal items among industrialized countries — are not much different from those presented by U.S. domestic postal services. The entire international postal system handles only about 7 billion items annually, about the size of Postal Service operations in Florida or Illinois. Fair and equitable allocation of costs, accurate accounts, avoidance of undue or unreasonable preference, cost-based conditions for downstream access, prohibition of anti-competitive conduct — such principles should apply to the international postal system in the much same way as they do to the domestic postal system. In opening this inquiry, the Commission has taken a pioneering first step in bringing light into postal corners where little light has shone since the late nineteenth century.

1 Comments relating to, or purporting to relate to, compliance of proposed rates and classifications with § 3622

In this proceeding, the major "proposals affecting market dominant rates and classifications for international postal products and services exchanged among postal administrations [Order No. 1420]" have been developed by the Postal Operations Council of the Universal Postal Union. These proposals include proposals relating to terminal dues rates for inbound letter post; restrictions on access to those rates; the procedure for establishing inward land rates for inbound parcels; and a floor on outbound international postage rates. Campbell at 17-24.

The Postal Service, which is most directly affected by the proposed rates, has not addressed inward land rates or limitations on the pricing of outbound letter post mail in any manner. The Postal Service has addressed terminal dues but avoided any discussion of the legal issue at the core of this proceeding — whether the proposed terminal dues rates for inbound international letter post items will be consistent with the criteria of § 3622 in the 2014 to 2017 period. At the same time, several parties have raised multiple and fundamental concerns respecting the provisions relating to terminal dues, inward land rates, and outbound letter post rates. Based on the record developed so far, there is no evidence to suggest the proposals affecting market dominant rates and classifications for international postal products and services exchanged among postal administrations can pass muster under the criteria of § 3622 and ample evidence to the contrary.

The only support offered for the rate-related proposals under consideration at the Doha Congress has been put forward by the Postal Service (and much more summarily by IMAG), and this support has been limited to POC proposals relating to terminal dues for mail exchanged among industrialized countries.

The Postal Service begins its initial comment by saying that "Only inbound terminal dues are evaluated in the context of section 407(b) [sic, should be (c)]," USPS at 3-4. But instead of considering the consistency of *inbound* terminal dues with the criteria of § 3622, the Postal Service devotes the bulk of its pleading to a discussion of terminal dues for *outbound* international mail. In brief, the Postal Service argues that the inbound terminal dues rates are traded — negotiated on a reciprocal case — for favorable terminal dues charges for delivery of outbound international mail. USPS at 11. These terminal dues rates will be favorable to the Postal Service in the 2014 to 2017 period because they will be substantially less than what the designated operator (DO) in the destination country will charge its own citizens for similar services. The Postal Service then claims that because foreign DOs will give the Postal Service favorable terminal dues for delivery of outbound mail, the Postal Service will then charge U.S. outbound mailers lower rates for outbound mail services. Unless this system of trading artificially low terminal dues continues, warns the Postal Service, "drastic increases in terminal dues rates could paralyze the mailing industry and have a devastating effect on mail volume and Postal Service revenue for outbound international mail." USPS at 8-9.

Besides being wholly unrelated to the legal criteria of § 3622 against which inbound terminal dues are to be measured by the Commission, the Postal Service's argument is factually incorrect in most cases and legally unacceptable in all cases. The great benefits claimed for outbound U.S. mailers in the future are illusory.

Let us start with the facts, or at least some facts. Since the Postal Service provides no data on the proportion of outbound postage rates accounted for by terminal dues, the prospects of industry paralysis due to extravagant terminal dues is wholly unsupported and unworthy of credit. However, it is possible to piece together estimates of the effects of higher terminal dues from other sources. Table 1 shows target system terminal dues as a proportion of USPS's outbound international mail prices according the UPU's Adrenale Report (2010):

Table 1. Target system TDs as percent of USPS First Class Mail Int'l Rates

First Class Mail Intl wt step	Outbound TD % of international postage
20 gram	43%
100 gram	22%
500 grams	13%
1 kg	21%
2 kg	40%

Source: Adrenale Report (2010) at 29

From this table it appears that a substantial increase in terminal dues would put pressure on outbound rates but hardly result in "paralysis" of international mail services.

For example, if, on average, terminal dues constitute about 33 percent of outbound international postage and terminal dues for international mail sent to other industrialized countries increase by about 65 percent,[1] then the rise in outbound international postage rates would be about 22 percent if the Postal Service immediately passes on the additional charges in higher postage rates.

Another perspective is given by the Commission's cost and revenue data. According to the 2011 Annual Compliance Report, outbound international mail services subject to terminal dues earned about $ 2.0 billion and incurred attributable costs of about $ 1.4 billion for a cost coverage of 147 percent.[2] Since the Postal Service offers no data on how outbound terminal dues aligned with bulk domestic postage would affect the costs of outbound international mail services, the best estimate in the record is my admittedly rough estimate — based on the conservative "base scenario" and other assumptions — that terminal dues aligned with domestic postage might increase the cost of outbound mail by about $ 191 million in 2014. Campbell at 57. Using 2011 cost and revenue date — the costs and revenues in 2014 are unknown — such an increase in outbound international mail costs would imply that the cost coverage for outbound letter post mail would drop from 147 percent to 129 percent *if the Postal Service does not raise outbound international mail rates by a penny*.

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[1]This is the average increase implied by the Bilateral Flow Model and the base scenario and related assumptions in 2014 in my initial comment. See Campbell at Appendix B, Table 10a-1-US, which suggests that outbound terminal dues to Group 1.1 countries would increase from $ 293 million under the POC proposal to $ 483 million under bulk domestic postage.

[2]See Table 4 of my initial comment, lines 3, 4, and 6. Table 4 was inadvertently omitted from my initial filing of this comment. Although I have filed a corrected copy, I also include a copy of Table 4 in this reply comment as well.

[From Campbell initial comment]

Table 4. USPS international mail covered by the Universal Postal Convention, FY 2011

		Volume (000)	Revenue ($ 000)	Attributable Cost ($ 000)	Contribution to Institutional Cost ($ 000)	Rev./Pc. (Cents)	Cost/Pc. (Cents)	Contribution to Institutional Cost/Pc. (Cents)	Cost Coverage
INTERNATIONAL MAIL									
1	**Letter post**								
2	Competitive (outbound)								
3	Total International Priority Mail	23,789	915,033	526,528	388,505	3,847	2,213	1,633	173.8%
4	Total International and NSA Mail	231,031	437,599	393,976	43,622	189.41	170.53	18.88	111.1%
5	Market dominant								
6	Outbound Single-Piece Mail Intl	310,335	648,080	438,476	209,605	208.83	141.29	67.54	147.8%
7	Inbound Single-Piece Mail Intl	238,078	216,756	249,709	(32,953)	91.04	104.89	(13.84)	86.8%
8	Inbound NSA Mail Intl - Standard	712	316	87	229	44.40	12.23	32.18	363.2%
9	Total letter post								
10	Outbound	541,366	1,085,679	832,452	253,227	200.54	153.77	46.78	130.4%
11	Inbound	238,790	217,072	249,796	(32,724)	90.91	104.61	(13.70)	86.9%
12	**Parcel post**								
13	Competitive								
14	Total International Priority Mail	Unknown							
15	Market dominant								
16	Inbound Surface Parcel Post (at UPU Rates)	1,017	24,250	10,725	13,525	2,383.78	1,054.29	1,329.49	226.1%
17	Inbound NSA Mail Intl - Packages	14	30	2	28	217.79	12.23	205.57	1781.3%
DOMESTIC MAIL		167,360,715	59,698,980	37,201,049	22,497,931	35.671	22.228	13.443	160.5%

Sources: PRC, "Annual Compliance Determination FY 2011," p. 31-32, Table IV-5. Data PRC Lib Ref, 11_Summary_LR1.xls.
Inbound Single-Piece Mail Intl is from CRA; no figure for Inbound FCMI-inbound in RPW report.

While a reduction in cost coverage would be undesirable from the commercial perspective of the Postal Service, such considerations strongly suggest the terrible consequences for international mailers which the Postal Service foresees in its initial comment are unfounded. In pricing outbound international mail it appears that the Postal Service has ample pricing flexibility to avoid “a hardship for both individual and business mailers” (USPS at 8); “significant rate increases and price fluctuation to many destination countries (USPS at 10); “real and probable risk of rate shock on mailers” (USPS at 10).

Moreover, this prospective increase in outbound terminal dues in 2014 does not consider the beneficial effects on inbound side of the equation. If inbound terminal dues were aligned with bulk domestic postage, the Postal Service would earn more on the delivery of inbound letter post mail. Again, since the Postal Service provides no data, I can only use the rough estimates developed in my initial comment. Under the base scenario and other assumptions listed there, in 2014 the Postal Service would earn about $ 154 million more than provided under the terminal dues proposed by the POC. This means that U.S. mailers collectively gain only $36 million as a result of the artificially low terminal dues rates proposed by the POC. Campbell at 57. This is essentially zero given the uncertainty of the estimates involved (whether mine or any one else’s), although the Postal Service does appear to receive more net benefit in later years.[3]

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[3]According to my estimates, the net gain from the POC proposal will increase significantly by 2017, perhaps rising something on the order of $108 million. Campbell at 58. At the same time, the uncertainties surrounding any estimates for the international postal system in 2018 rise as well.

Yet even if this trading of underpriced terminal dues would produce substantially reduced outbound postage rates for outbound international mailers, the mechanism must be considered per se illegal under the postal law. Lower terminal dues rates for Inbound Single-Piece Mail means higher rates for mailers of market dominant First Class mail because Inbound Single-Piece Mail is under the statutory cap for First Class mail. At the same time, lower terminal dues rates for outbound international mail *might* be passed through by the Postal Service and reflected in lower rates for outbound mailers of competitive mail products since 85 to 90 percent of outbound mail revenue is earned from competitive products. Campbell at 58 to 61. What the Postal Service is saying that higher rates for First Class mailers are being traded for lower rates for competitive products. In this manner, low prices for competitive outbound international mail products are being cross-subsidized from revenues of market dominant First Class mail in direct violation of § 3633(a)(1), which requires the Commission to "prohibit the subsidization of competitive products by market dominant products."

Although it appears from the cost coverage for outbound international mail that the Postal Service should be able to manage the rate implications of higher terminal dues for outbound international mail, there are specific situations in which substantially higher terminal dues could lead directly to substantially higher rates of international mailers. This situation occurs when the rate for a particular international mail product is set at or near attributable costs. In such cases, higher costs will require the Postal Service to charge higher rates immediately because the rate for each competitive product much cover its attributable cost.

In its initial comment, the Postal Service's gave three examples saying that IPA and ISAL rates to Denmark could increase by 150 percent, with increases of 120 percent for service to Norway and 70 percent for service to France. USPS at 8. Based on the overall cost coverage for outbound international mail and my own analysis, it seems clear that the Postal Service has picked a few especially egregious but unrepresentative examples. Without a complete exposition of relevant data, it is impossible to assess the true extent of the issues the Postal Service is raising.

Nonetheless, let us consider these examples. In the case of Denmark, what the Postal Service is saying that if Post Denmark were to charge terminal dues properly aligned with the domestic postage rates — the same postage rates that Danish citizens pay — then the Postal Service's attributable cost for IPA and ISAL services to Denmark would increase by roughly 150 percent. Since the domestic postage charged by Post Denmark is, under Danish law, based on costs, this means the Postal Service is selling IPA and ISAL services to Denmark at prices that are so low the Postal Service's total end-to-end cost is only about 40 percent of the actual attributable cost — i.e., the attributable cost that would result if all Danish delivery costs were recorded in the same way the Commission requires for domestic costs. Obviously, such statements by the Postal Service strongly support the Nordics' complaints about unfair treatment. There is no possible reason why Danish mailers should subsidize U.S. outbound mailers in this manner.

But there is a more subtle and important implication as well. If the Postal Service's IPA and ISAL rates to Denmark are set close to the Postal Service's attributable costs, then these services are dependent on false accounting. The Postal Service is able to sell a service at a price that is substantially below the real cost of production only because terminal dues do not reflect true costs. As the Postal Service says, “terminal dues negotiated in the UPU are reciprocal.” USPS at 11. The Postal Service is, in effect, paying (at least in part) for the privilege of low terminal dues access to the Danish postal system by giving Post Denmark low terminal dues access to the U.S. postal system. Therefore, a significant portion of the real cost to the Postal Service of this reciprocal arrangement is made up of uncompensated costs incurred in delivering inbound Danish mail. This “reciprocal” inbound cost is not reflected in the terminal dues costs which the Postal Service attributes to its IPA and ISAL services. The bottom line is the Postal Service may be showing a profit on IPA and ISAL services to Denmark when they are, in reality, loss-making products. As the Commission well understands in a domestic regulatory setting, such are the risks of accounting practices that do not accurately reflect actual costs.

Finally, in order to make still clearer what is going on in the reciprocal exchange of artificially low terminal dues, it may be helpful to consider an equivalent domestic business arrangement that avoids the mysteries of terminal dues, the UPU, and IPA service to the Far North. Suppose the Postal Service made a deal with Company X, a large American private delivery service. The Postal Service agrees to provide Company X with a full range of postal services that are priced at 50 percent of the rates charged other U.S. mailers for similar services. In return, the Company X agrees to deliver business parcels at rates that are 50 percent of the rates that it normally charges its other customers. Based on these extremely low parcel delivery rates, the Postal Service starts a new service for business parcels that features very low prices. This new business parcel service is priced aggressively and does well enough to report a reasonable profit. If the Commission were asked for its views on whether the postage rates that the Postal Service charges Company X — 50 percent less than charged other mailers — are consistent with the standards of § 3622, can there any doubt that the Commission would answer in the negative? I do not think so. Yet there is no essential difference between that arrangement and the POC proposal for terminal dues to be charged on the exchange of letter post mail among DOs in industrialized countries.

2 Impact on foreign posts

The Postal Service warns that "Efforts to remove the cap on terminal dues, as suggested in Proposal 81, would have a drastic and devastating effect on many foreign postal operators and their international mailers." USPS at 12. This statement appears intended to impress the Commission with vague but grave consequences that are not only unsubstantiated but entirely devoid of substance.

The level of terminal dues, whether capped or uncapped, has no effect whatsoever on the cost of producing postal services. Terminal dues are accounting entries between origin and destination postal units. The Postal Service's grave prognostication is comparable to a claim that "If the Postal Service is required to allocate collection and delivery costs among its various facilities in a more cost-based manner, this would have a drastic and devastating effect on the Postal Service and domestic mailers!"

If terminal dues are better aligned with domestic postage in the Group 1.1 system of DOs, what will happen is that distortions among DOs will disappear. DOs that are not paying their fair share of delivery costs will be "harmed" by having to pay a fair share. On the other hand, DOs which are not receiving a fair amount for the delivery of inbound international mail will be better compensated. The overall effect on Group 1.1 DOs and their customers collectively will be zero because each distortion in the POC proposal necessarily produces a loser for each winner.

3 Postal Service's comments on my initial comment

In its initial comment, the Postal Service offered some corrections to factual errors in the draft comment that I filed on August 14 (for reasons explained that filing). I shall respond to the most important points briefly.

On page 13, the Postal Service says that I incorrectly stated that Brazil is opposed to the terminal dues system proposed by POC. Let me explain. There are no minutes of the February 2012 meetings of POC and CA that I am aware of. In February 2012, I attended the meetings of the CA devoted to the POC terminal dues proposal. It was evident from the discussion that the level of unhappiness in the POC meetings, which had just ended, was so high that POC was forced to substantially revise its terminal dues proposal at the last minute in order to obtain approval of a majority of POC members. The basic change was to delay incorporation of Group 3 DOs into the target system from 2014 to 2016 and to postpone incorporation of Groups 4 and 5 after 2017 at the earliest.[4] In the CA meetings which I attended, there remained a very high level of dissatisfaction. The delegation from China led a number of other delegations which argued, inter alia, that “No proper study has been conducted to ascertain whether the proposed rate increases are justified and sustainable.”[5] Subsequently, Brunei Darussalam, Cambodia, China (People's Rep.), Iran (Islamic Rep.), Korea (Rep.),Malaysia, Nepal, Philippines, Samoa, Singapore, Thailand, and Turkey have collectively introduced proposals to substantially amend the POC proposal.[6] At the same CA meeting, Denmark and Norway also strongly criticized the POC proposal, voicing concerns similar to those expressed in the Nordic contribution in this inquiry. Leaders of the CA repeatedly expressed alarm that failure of the CA to endorse the POC proposal would mean that the Doha Congress would convene with no proposal for terminal dues. They urged CA members to agree to forwarding the POC proposal to the Doha Congress with the understanding that further changes could be considered. Although I did not attend the final meeting of the CA on March 2, colleagues who did attend said that it was chaotic. From this rather confused experience, my recollection was that Brazil was one of the many delegations that voiced reservations about the POC proposal. However, I have no reason to doubt the Postal Service’s statement that I am mistaken in this recollection, and I apologize for any confusion that may have

[4]The terminal dues groups are described in Campbell at 17-18.

[5]See UPU, Doha Congress, Proposal 20.28.4. See next note.

[6]These proposals are 20.27.7, 20.28.4, and 20.29.4.

caused in the Commission's review of my initial comment.

On page 14, the Postal Service states:

> Mr. Campbell states that "[i]n actuality, in almost no country is the terminal dues reflective of domestic postage". This is also incorrect, as the new methodology being proposed to the Doha Congress does in fact reflect a best-fit linearization of 15 domestic rates collected by the International Bureau.

Let me be more precise. According to my calculations in 2014, of the 41 DOs in Group 1.1 — the DOs from 24 substantial countries and the DOs from smaller states and territories— the terminal dues for 32 DOs are fixed by the cap (and in some cases further limited by the 13 percent annual limit), and the terminal dues of 5 DOs are fixed by the floor. The only DOs which will charge terminal dues rates based on the "best-fit linearization" are the DOs of Gibralter, Guernsey, Israel, and Jersey. Thus, under the POC proposal, well over 99.5 percent of the terminal dues paid by Group 1.1 DOs for intra-Group 1.1 letter post items will be established by the cap or the floor, not by a "best-fit linearization."

On page 14, the Postal Service states that "the model [Campbell] uses does not reflect real mail volumes between France and the U.S, which bear no relation to the value of trade" and implies that this error invalidates my use of the Bilateral Flow Model to draw conclusions about whether the POC proposal is consistent with the national policy "to promote and encourage unrestricted and undistorted competition in the provision of international postal services and other international delivery services." § 407(a)(2). I cannot agree.

As explained in my initial comment, by allocating outbound mail volumes according to trade-in-services data

> it is possible to construct a "Bilateral Flow Model" for letter post between Group 1.1 DOs that is internally consistent and broadly plausible. The resulting bilateral mail volumes are certainly not accurate, but differences that emerge when two different sets of terminal dues charges are applied to the model should illuminate real differences between the two terminal dues systems. [Campbell at 34]

Since bilateral mail volumes are non-public the only way to gain insight into the effects of the POC proposal on the commerce among a set of countries like the Group 1.1 countries is to develop some sort of model. The usefulness of my model depends primarily on whether trade-in-services revenues represents a broadly reasonable indicator of mail volume. Perfection is not required since it is primarily the differences that emerge from different scenarios and terminal dues systems that are being tested. My assumption that trade-in-services data would serve for this purpose was based on research by Martin Zauner, an economist in WIK with whom I worked on a study for the European Commission. His summary email to me was on June 14, 2010, concluded:

> The best regression seems to be between total exports services (ExpServ) and LpOut with r2=0.8639 Regression bewteen [sic] overall total exports (ExpTot) and LpOut: r2=0.6144 Regression total exports commodities (ExpComm) and LpOut: r2=0.5126

"Total exports services" refers to an earlier version of the OECD data that I used for my comments. As I indicated in Appendix B of my initial comment, I will be glad to provide the Commission with the calculations underlying my initial comment, including Mr. Zauner's analysis.[7]

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[7] I have no objection to publication as library references, but such a procedure seems excessive for an initial inquiry devoted guiding principles.

4 Next steps

The Postal Service concludes its initial comment as follows:

> [T]the Commission is tasked solely with providing its view as to whether certain proposals that affect market dominant products are consistent with the standards and criteria of section 3622. . . . [T]he Postal Service recommends that the Commission present a view to the State Department endorsing the proposals submitted by the CA/POC as they best satisfy the statutory requirements of title 39 and best effectuate the policies, objectives and factors in 39 U.S.C. § 3622.

The Postal Service overlooks the fact that, as a federal regulatory agency, the Commission must comply with the Administrative Procedure Act (APA). As explained in my initial comment, the § 407(c) opinion which the Commission is required to submit to the Department of State represents a final regulatory determination with respect to the consistency of "proposals affecting market dominant rates and classifications for international postal products and services exchanged among postal administrations [Order No. 1420]" with the criteria of § 3622. This determination will have substantial legal and commercial consequences for a wide range of parties for four years, until the end of 2017. Although arising in somewhat unusual circumstances, the Commission's § 407(c) opinion is, in APA terms, a "legislative rule" or "substantive rule" closely akin to the Commission's final determination in its annual review of adjustments in domestic postage rates under § 3622(d).

The present initial inquiry into the principles which should guide the Commission in conducting a § 407(a) review is a welcome step forward in bringing greater transparency and reasoned economic analysis to U.S. policymaking in the field of international postal policy. This initial inquiry does not, however, comply with the requirements of the Administrative Procedure Act as they apply to agency development of a "legislative rule." Even if it did, the rulemaking record is devoid any evidence that would support a conclusion that the terminal dues rates for inbound letter post; the restrictions on access to those rates; the procedure for establishing inward land rates for inbound parcels; and the floor on outbound international postage rates are consistent with the criteria of § 3622. Neither as a matter of administrative procedure nor as a matter of substance is the Commission in a position in which it can provide a § 407(c) opinion to the Department "endorsing the proposals submitted by the CA/POC."

As explained in my initial comment, given the imminence of the Doha Congress, it seems to me that the best course for the U.S. government — indeed, the only course at this stage — is to take such steps at the Doha Congress as may be necessary to preserve the jurisdiction of the Commission to conduct a § 407(c) review after the close of the Congress but well in advance of the implementation of the next UPU Convention, January 1, 2014. Such a position protecting the authority of the Commission to implement U.S. regulatory law would closely parallel the declaration made by member countries of European Union at the end of each UPU Congress proclaiming the continuing supremacy of European law. It will in no way prejudice the ability of other UPU member countries to place the next Convention into effect in a timely manner.

Respectfully submitted,

James I. Campbell Jr.

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